REPORTER
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Charitable Giving Through Community Foundations

by Nancy G. Fax

If you are charitably inclined and you wish to support community-based philanthropy, consider conducting your charitable giving through a community foundation. A community foundation is a public charity, managed by a board of directors made up of members of the local community.

DONOR-ADVISED FUNDS

Community foundations house and manage multiple donor-advised funds. A donor-advised fund is a charitable fund established by an individual or family. Such a fund is owned by the community foundation, but the donor advises the foundation board of directors about making grants from the fund to nonprofit organizations.

Donor-advised funds range in size from $10,000 to millions of dollars. The nonprofit recipients of grants from donor-advised funds may be organizations within the local community, or may be charities of special interest to the donor that are outside the local community, such as the donor's alma mater or a national nonprofit organization.

COMMUNITY FUNDS

In addition to donor-advised funds, community foundations have common funds or community funds that are distributed among charitable organizations in the local community in the discretion of the foundation's board of directors. The board of directors solicits grant requests from local nonprofit organizations and selects the recipients of grants from the community fund after making site visits, evaluating the proposals and considering the overall impact of the organization's activities on the community.

COMMUNITY FOUNDATION DONOR-ADVISED FUNDS VS. PRIVATE FOUNDATIONS

A donor-advised fund at a community foundation operates like a private foundation in terms of the grant-making function, but there are certain advantages in establishing a donor-advised fund within a community foundation rather than a private foundation.

Unlike community foundations, which are public charities, private foundations are private nonprofit organizations. Because community foundations are public charities, more generous income tax deductions are available for contributions to community foundations than are available for contributions to private foundations. Contributions of cash to a community foundation are deductible up to 50 percent of the donor's adjusted gross income (AGI), as compared with the 30 percent deduction allowed for cash contributions to a private foundation. The deduction limit applicable to contributions of long-term capital gain property to a community foundation is 30 percent of the donor's AGI, while the deduction limit for contributions of long-term capital gain property to a private foundation generally is limited to 20 percent of the donor's AGI.

A private foundation must distribute at least 5 percent of its assets to nonprofit organizations each year. By contrast, there is no minimum distribution requirement imposed on a donor-advised fund at a community foundation.

A private foundation must file various forms and returns with the Internal Revenue Service, both to establish its tax-exempt status and to report its

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Attention Trustees and Beneficiaries

by Nancy G. Fax

Each of the three local jurisdictions has adopted a uniform law which may have important ramifications for beneficiaries of some irrevocable trusts. The main purpose of the Uniform Principal and Income Act (UPIA) is to provide rules for the apportionment of receipts and disbursements between the income and principal of a trust. However, the most recently enacted sections of the UPIA permit the trustee to alter the amounts allocated to beneficiaries under certain circumstances. This article will summarize these new provisions of the UPIA.

TOTAL RETURN INVESTING

Each jurisdiction adopted its version of the UPIA in response to the adoption of the prudent investor rule. The prudent investor rule embraces the theory of modern portfolio management, which focuses on total return investing. The goal of investing for total return is to maximize the total investment return, without regard to the character of the investment return (income vs. growth of principal). Applying the new investment practices to trusts that operate under traditional principal and income accounting rules could produce unacceptable results for the income or remainder beneficiaries of such trusts. For instance, investing to produce growth of principal to protect what will be received by the remainder beneficiaries when the trust terminates may significantly reduce income payable to the current income beneficiary. Similarly, investing to produce income would be beneficial to the income beneficiaries, but the remainder beneficiaries probably would prefer an investment strategy that includes growth of principal. That is where the new provisions of the UPIA come in.

MARYLAND—NEW LAW

Maryland's new UPIA provisions, effective October 1, 2002, permit trustees (i) to convert a beneficiary's income distribution to a fixed percentage of trust assets each year (called a unitrust interest) or (ii) to adjust distributions to beneficiaries by allocating principal to income or vice versa. Thus, a trustee can reallocate distributions between the income and remainder beneficiaries, either by converting to a unitrust or by adjusting income and principal allocations. The purpose of these adjustments is to permit trustees to develop appropriate investment policies without penalizing either the life income beneficiaries or the remainder beneficiaries.

A trustee may exercise the power to convert to a unitrust or adjust between principal and income only upon the written request of a trust beneficiary. Therefore, the initial responsibility is on the beneficiary to determine whether conversion or adjustment would produce better results. After a request by a beneficiary is made, the burden shifts to the trustee to consider all relevant factors in deciding whether to exercise the conversion or adjustment power. Generally speaking, any individual serving as a trustee would be well-advised to seek an expert analysis of the relevant factors before deciding whether or not the exercise of the power would be advisable under the particular circumstances of the trust. If the trustee determines that the conversion or adjustment will enable the trustee to better carry out the intent or purposes of the trust, then the trustee must obtain either the consent of all trust beneficiaries or a court order approving the action.

Maryland's new UPIA applies to all trusts existing on or after the effective date (October 1, 2002).

DISTRICT OF COLUMBIA AND VIRGINIA—NEW LAW

Under the current version of the UPIA as enacted in the District of Columbia and Virginia, a trustee has the power to adjust between principal and income, but not the power to convert to a unitrust. This means a trustee in these jurisdictions may be able to make distributions of principal to the income beneficiary if the income produced by the trust is less than desirable because of total return investing. Because the unitrust conversion feature of the UPIA is relatively new, it is possible

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D.C. Domestic Relations Law Amendments

by Linda J. Ravdin

The Council of the District of Columbia has enacted important changes to the District's domestic relations laws. The changes to the equitable distribution and alimony statutes are the first since the District enacted its modern divorce statute in 1977.

Alimony. D.C. has finally joined every other jurisdiction in permitting rehabilitative alimony. The statute uses the term "term-limited" to describe this type of alimony and to distinguish it from indefinite alimony. It will be interesting to see whether judges interpret this term broadly so as to permit termination upon the happening of a specified event, such as sale of a home, a party becoming eligible for retirement benefits, or a party's attainment of a degree or a specified salary. This common sense interpretation of the statute would permit the court to fashion an award appropriate to the circumstances. That the statute expressly provides for consideration of potential income from property and the right to receive retirement benefits in determining an award suggests that a broad interpretation is what the Council intended.

Prior law did not provide for automatic termination of alimony upon remarriage. The amendments do not specifically provide for termination upon remarriage, but the power to enter a term-limited award should be interpreted to permit the court to order termination upon the happening of a specified event, such as remarriage. Because the newly amended statute still does not provide for automatic termination upon remarriage, counsel for the payer of the alimony should ask the court to include such a provision in its order.

The Council codified current thinking about the purpose of alimony to flesh out the criteria for deciding an alimony claim. The criteria now include the time and cost to obtain additional education or training, the reality of two households, income a party could generate from non-income producing assets, and the tax consequences of an award.

Equitable Distribution of Property at Divorce. The list of criteria for the court to consider in dividing property has been expanded to include contributions to a spouse's career, career sacrifices, and tax consequences of division of property. The addition of these criteria do not appear to make any change in prior law. Interestingly, the statute now also specifically authorizes the court to consider whether property was acquired after the date of separation. Whether judges will read that amendment as an invitation to routinely award post-separation assets to the title-holder, or will only do so under special circumstances, such as when the parties were separated for 20 years, remains to be seen.

Also interesting is the added express authority to consider the causes of the breakup of the marriage. Fault has generally seemed to play a relatively insignificant role in determining division of property except in unusual circumstances. Will judges gives more weight to fault now that it is specifically mentioned in the statute?

The statute now expressly permits the court to allocate responsibility for payment of debt accumulated during the marriage. Trial judges have always had the ability to take debt into account as part of the overall division of property. But the law was somewhat unclear about whether the court had the power to allocate debt in those cases where the parties had nothing but debt or where debts exceeded assets. Now that authority is explicit.

Child Support. The amendment explicitly includes in gross income the tax liability that would be incurred on income that is either not taxed or on which the employer pays the tax on behalf of the employee. Employees of international organizations seem to be the target of this amendment, but the amendment has application to many others, including active duty military, military people retired on VA disability, other retirees receiving non-taxable disability income, and payees of all kinds who receive nontaxable income, such as income from municipal bonds, the non-taxable portion of Social Security, a nontaxable perquisite or in-kind employee benefit. There are few wage-earners who do not receive some employee benefits. Will judges apply this amendment to all forms of nontaxable income so that a grossing-up calculation will have to be made in virtually every case?

Child-care expenses had not been defined in the child support statute. Now they are and the definition includes camp and pre- and after-school care. Importantly, the definition now also includes such expenses incurred to enable a party to obtain education. This is likely to become increasingly important now that the court can award rehabilitative alimony.

The court can now allocate responsibility between joint custodians for a whole host of expenses that are not tied to where a child happens to be sleeping on any given night, such as private school, uninsured medicals, extracurricular activities, and the like. The prior version of the statute did not specifically authorize the court to

Linda Ravdin is co-author of *Domestic Relations Manual for the District of Columbia* (LexisNexis Matthew Bender 2002). She is a member of the American Academy of Matrimonial Lawyers.

allocate these in addition to making an award of basic support. With the increasing frequency of joint custody arrangements, the lack of specific statutory authority to allocate responsibility for these expenses made for much uncertainty. Clarification should enable parties to get to settlement more readily. Importantly, the amendment appears to authorize an award for private school expenses even when the child is not learning disabled or otherwise in need of private school to meet a special educational need. ●

ATTENTION TRUSTEES AND BENEFICIARIES

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that either or both jurisdictions will adopt some form of the unitrust conversion option at a later date.

The D.C. and Virginia statutes give the trustee the authority to initiate the adjustment process without the involvement of any of the beneficiaries. However, the trustee still must undertake the analysis of all relevant factors in deciding whether to exercise the adjustment power.

The current version of the D.C. UPIA became effective on April 27, 2001 and the current version of the Virginia UPIA became effective on January 1, 2000. Each statute generally applies to all trusts existing on or after the effective date.

FURTHER INFORMATION

If you are a trustee or a beneficiary of a trust and you want further information about the unitrust conversion or the power of the trustee to adjust between principal and income, please contact a member of our Estate Planning and Administration Group. ●

PASTERNAK & FIDIS, P.C.

NEWS

Nancy Fax authored an article entitled "Community Foundation Donor-Advised Funds: Efficient and Effective Charitable Giving," which was published in the March/April, 2003 edition of *The Maryland Bar Journal.*

Nancy Fax and Montgomery County Register of Wills, Joseph Griffin, recently taped a program for the cable television production of Law School for the Public. The program, on the topic of probate in Montgomery County, is being aired on Montgomery Community Television Channels 21, 23 and 49 on certain Tuesdays at 8:30 PM.

Nancy Fax has been elected as Secretary of the Section Council of the Estates and Trusts Section of the Maryland State Bar Association for the fiscal year beginning July 1, 2003.

On June 10, 2003, Jan White and Linda Ravdin will teach "Family Law Around the Beltway." This sophisticated program, designed for experienced domestic law practitioners, teaches attorneys the differences and the similarities in the law and procedure for divorce, custody, spousal support, and asset division in the District of Columbia, Maryland and Virginia. This is the fourth year that Jan White has been the course designer and chair and the third year that Linda Ravdin has been a presenter at this popular program offered by the District of Columbia Bar.

Linda Ravdin authored an article "Premarital Agreements: Trends and Recent Developments," in *Divorce Litigation* (Vol 15, No. 2), February, 2003. Call Pamela Stuart-Mills in our office if you would like a copy.

Nancy Fax participated in a panel presentation at the American Bar Association, Section on Taxation annual meeting on May 10, 2003 in Washington, D.C. The topic of the presentation was the Uniform Trust Code, which is a comprehensive trust code drafted by the National Conference of Commissioners on Uniform State Laws. Ms. Fax has been actively involved in efforts in the District of Columbia and Maryland to study, modify and enact the Uniform Trust Code.

On June 19, 2003, Nancy Fax will be speaking with representatives from Chevy Chase Trust Company at Leisure World on the topic of Investment and Tax Strategies in Retirement.

P & F welcomes Jennifer J. McCaskill as a new Associate in the Divorce and Family Law Group. Jennifer has a J.D. from the Columbus School of Law at The Catholic University of America and a B.A. from Gettysburg College. She has worked as an intern at a Survivor's Shelter for Battered Women and as a Volunteer Court Advocate with the D.C. Coalition Against Domestic Violence. Jennifer is a member of the Virginia Bar.

Patrick M. Schoshinski joined Pasternak & Fidis in May, 2003 as an Associate in the Estate Planning and Administration Group. Patrick comes to us from Patton Boggs in McLean, Virginia where his practice included structuring and implementing sophisticated estate plans for high net worth individuals and advising clients on federal and local tax matters. He holds an L.L.M. degree in taxation from Georgetown University Law Center, a J.D. from Gonzaga University School of Law in Spokane, Washington, and a B.A. from Mount Saint Mary's College in Maryland. He is a member of the Maryland, Virginia and D.C. Bars.

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What is a Family Limited Partnership and What Does It Do

by N. Alfred Pasternak and Marcia C. Fidis

A Family Limited Partnership (FLP) is an estate planning tool that has several advantages. It allows an individual to make substantial transfers of assets in a tax-efficient manner while still maintaining extensive control over those assets. It also provides an excellent vehicle for managing a family's assets, particularly real estate. Finally, in many cases, FLPs can protect assets from potential creditors of the owners of the FLP.

An FLP is established by transferring assets into a partnership in exchange for general and limited partnership interests. The general partner (usually the parent who transferred assets to the partnership or a corporation owned by the parents) maintains complete control over assets held by the partnership but can transfer the limited partnership interests that make up the bulk of the value of the assets to family members.

Limited partnership interests that are gifted to family members qualify for substantial discounts for gift tax purposes for a variety of reasons. These discounts are referred to as "minority interest" and "lack of marketability" discounts. They arise from the facts that limited partners have no say regarding management of partnership assets and can only sell or transfer their interests under limited circumstances. Any distributions to the partners are at the discretion of the general partner.

FLPs also help insulate partnership assets from claims by creditors. Parents concerned that their children may lose assets due to lawsuits or divorce find this feature attractive.

In addition, the general partner can retain the right to modify the partnership agreement without causing assets in the partnership to revert to his or her taxable estate.

Another substantially similar alternative that can accomplish the same objective is the Family Limited Liability Company (FLLC). Instead of using a partnership to hold the assets, a limited liability company is formed under state law and the assets are transferred to the FLLC. Instead of a "general partner", the FLLC is managed by a "Manager" who, as in the case of the FLP, may be the person who transferred assets to the FLLC (generally the parent). The owners of the FLLC are referred to as "Members". A member can also transfer a part of his or her membership interest to other family members with "lack of marketability" and "minority interest" discounts that can result in very substantial gift tax savings.

In short, FLPs and FLLCs are flexible and tax efficient methods of managing, protecting and transferring assets to future generations without surrendering control of those assets.

HAVE YOU REFINANCED AND SHOULD YOU REFINANCE AGAIN?

Interest rates are still at record low levels. If you are considering refinancing your home, please call our real estate attorneys to analyze the costs and benefits, order a title search and otherwise perform escrow and closing services. We conduct real estate settlements efficiently and professionally, with customer service and satisfaction our primary goals. If tax or other related legal issues need to be addressed our firm's attorneys are able to provide the required counsel.

CHARITABLE GIVING THROUGH COMMUNITY FOUNDATIONS

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financial standing on an annual basis. There are no filing requirements imposed upon donor-advised funds at community foundations.

Because the community foundation administers the donor-advised fund for the donor, the overall administrative costs associated with such a fund are far less than the costs involved in managing a private foundation. In addition, the management of a private foundation requires a substantial commitment of time and energy by the donor, the donor's family and/or staff. The community foundation offers an umbrella organization for the efficient management of the funds of numerous donors and their families.

Private foundations have an important place in the universe of charitable giving. The donor-advised fund at a community foundation should be considered as a viable alternative, however, when the amount of funding and/or the level of commitment of the donor and the donor's family do not justify the establishment of a separate legal entity.

COMMUNITY FOUNDATIONS IN THE D.C. METROPOLITAN AREA

The principal community foundation in our area is the Community Foundation for the National Capital Region (CFNCR). CFNCR has two regional affiliates, The Montgomery County Community Foundation and Prince George's Community Foundation. In addition, there are several community foundations in Northern Virginia, including Arlington Community Foundation and Northern Virginia Community Foundation.

FOR MORE INFORMATION

Nancy Fax, a principal of Pasternak & Fidis, is a member of the board of The Montgomery County Community Foundation (MCCF) and chairs MCCF's Professional Advisors Council. For more information about any of the local community foundations, please contact Nancy and she will be happy to discuss the wide array of charitable giving options available through our local community foundations.

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N E W S

Our newest paralegal joined the Estate Planning and Administration Group in May. Mark Roberson brings to the firm extensive experience managing financial transactions for a large consumer credit organization. He has a B.S. in Finance from Arkansas State University and will complete his paralegal certification in December at Georgetown University.

Pamela Stuart-Mills, legal secretary to P & F's Domestic Group, was recently a guest at a White House Rose Garden ceremony with the family of Elizabeth Smart, John Walsh, Senators Diane Feinstein, Patrick Leahy and others as President George W. Bush signed the Amber Alert bill into law. The Amber law marks important progress in the protection of children by setting up a nationwide alert system for abducted children. Pamela is the co-founder of the Rachel Foundation (www.rachelfoundation.org) which provides the nation's first family reintegration program for returning abducted children.

P & F Managing Partner, Marcia C. Fidis, has received the President's Citation for Outstanding Service from the Montgomery County, Maryland Bar Foundation for her work in designing and implementing a Charitable Remainder Trust for the Foundation. This allowed the Bar Foundation to successfully negotiate for the purchase of the Foundation's Headquarters Building in downtown Rockville.

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